

(d) *Effective date.* This section is effective for taxable years beginning after December 31, 1986.

[T.D. 8205, 53 FR 19703, May 27, 1988]

§ 1.444-4 Tiered structure.

(a) *Electing small business trusts.* For purposes of § 1.444-2T, solely with respect to an S corporation shareholder, the term *deferral entity* does not include a trust that is treated as an electing small business trust under section 1361(e). An S corporation with an electing small business trust as a shareholder may make an election under section 444. This paragraph is applicable to taxable years beginning on and after December 29, 2000; however, taxpayers may voluntarily apply it to taxable years of S corporations beginning after December 31, 1996.

(b) *Certain tax-exempt trusts.* For purposes of § 1.444-2T, solely with respect to an S corporation shareholder, the term *deferral entity* does not include a trust that is described in section 401(a) or 501(c)(3), and is exempt from taxation under section 501(a). An S corporation with a trust as a shareholder that is described in section 401(a) or section 501(c)(3), and is exempt from taxation under section 501(a) may make an election under section 444. This paragraph is applicable to taxable years beginning on and after December 29, 2000; however taxpayers may voluntarily apply it to taxable years of S corporations beginning after December 31, 1997.

(c) *Certain terminations disregarded—*
(1) *In general.* An S corporation that is described in this paragraph (c)(1) may request that a termination of its election under section 444 be disregarded, and that the S corporation be permitted to resume use of the year it previously elected under section 444, by following the procedures of paragraph (c)(2) of this section. An S corporation is described in this paragraph if the S corporation is otherwise qualified to make a section 444 election, and its previous election was terminated under § 1.444-2T(a) solely because—

(i) In the case of a taxable year beginning after December 31, 1996, a trust that is treated as an electing small business trust became a shareholder of such S corporation; or

(ii) In the case of a taxable year beginning after December 31, 1997, a trust that is described in section 401(a) or 501(c)(3), and is exempt from taxation under section 501(a) became a shareholder of such S corporation.

(2) *Procedure—*(i) *In general.* An S corporation described in paragraph (c)(1) of this section that wishes to make the request described in paragraph (c)(1) of this section must do so by filing Form 8716, “Election To Have a Tax Year Other Than a Required Tax Year,” and typing or printing legibly at the top of such form—“CONTINUATION OF SECTION 444 ELECTION UNDER § 1.444-4.” In order to assist the Internal Revenue Service in updating the S corporation’s account, on Line 5 the Box “Changing to” should be checked. Additionally, the election month indicated must be the last month of the S corporation’s previously elected section 444 election year, and the effective year indicated must end in 2002.

(ii) *Time and place for filing Form 8716.* Such form must be filed on or before October 15, 2002, with the service center where the S corporation’s returns of tax (Forms 1120S) are filed. In addition, a copy of the Form 8716 should be attached to the S corporation’s short period Federal income tax return for the first election year beginning on or after January 1, 2002.

(3) *Effect of request—*(i) *Taxable years beginning on or after January 1, 2002.* An S corporation described in paragraph (c)(1) of this section that requests, in accordance with this paragraph, that a termination of its election under section 444 be disregarded will be permitted to resume use of the year it previously elected under section 444, commencing with its first taxable year beginning on or after January 1, 2002. Such S corporation will be required to file a return under § 1.7519-2T for each taxable year beginning on or after January 1, 2002. No payment under section 7519 will be due with respect to the first taxable year beginning on or after January 1, 2002. However, a required payment will be due on or before May 15, 2003, with respect to such S corporation’s second continued section 444 election year that begins in calendar year 2002.

(ii) *Taxable years beginning prior to January 1, 2002.* An S corporation described in paragraph (c)(1) of this section that requests, in accordance with this paragraph, that a termination of its election under section 444 be disregarded will not be required to amend any prior Federal income tax returns, make any required payments under section 7519, or file any returns under § 1.7519-2T, with respect to taxable years beginning on or after the date the termination of its section 444 election was effective and prior to January 1, 2002.

(iii) *Section 7519: required payments and returns.* The Internal Revenue Service waives any requirement for an S corporation described in paragraph (c)(1) of this section to file the federal tax returns and make any required payments under section 7519 for years prior to the taxable year of continuation as described in paragraph (c)(3)(i) of this section, if for such years the S corporation filed its federal income tax returns on the basis of its required taxable year.

[T.D. 8994, 67 FR 34394, May 14, 2002]

METHODS OF ACCOUNTING

METHODS OF ACCOUNTING IN GENERAL

§ 1.446-1 General rule for methods of accounting.

(a) *General rule.* (1) Section 446(a) provides that taxable income shall be computed under the method of accounting on the basis of which a taxpayer regularly computes his income in keeping his books. The term “method of accounting” includes not only the overall method of accounting of the taxpayer but also the accounting treatment of any item. Examples of such over-all methods are the cash receipts and disbursements method, an accrual method, combinations of such methods, and combinations of the foregoing with various methods provided for the accounting treatment of special items. These methods of accounting for special items include the accounting treatment prescribed for research and experimental expenditures, soil and water conservation expenditures, depreciation, net operating losses, etc. Except for deviations permitted or re-

quired by such special accounting treatment, taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books. For requirement respecting the adoption or change of accounting method, see section 446(e) and paragraph (e) of this section.

(2) It is recognized that no uniform method of accounting can be prescribed for all taxpayers. Each taxpayer shall adopt such forms and systems as are, in his judgment, best suited to his needs. However, no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income. A method of accounting which reflects the consistent application of generally accepted accounting principles in a particular trade or business in accordance with accepted conditions or practices in that trade or business will ordinarily be regarded as clearly reflecting income, provided all items of gross income and expense are treated consistently from year to year.

(3) Items of gross income and expenditures which are elements in the computation of taxable income need not be in the form of cash. It is sufficient that such items can be valued in terms of money. For general rules relating to the taxable year for inclusion of income and for taking deductions, see sections 451 and 461, and the regulations thereunder.

(4) Each taxpayer is required to make a return of his taxable income for each taxable year and must maintain such accounting records as will enable him to file a correct return. See section 6001 and the regulations thereunder. Accounting records include the taxpayer's regular books of account and such other records and data as may be necessary to support the entries on his books of account and on his return, as for example, a reconciliation of any differences between such books and his return. The following are among the essential features that must be considered in maintaining such records:

(i) In all cases in which the production, purchase, or sale of merchandise of any kind is an income-producing factor, merchandise on hand (including finished goods, work in process, raw